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8 **UNITED STATES DISTRICT COURT**
9 **SOUTHERN DISTRICT OF CALIFORNIA**
10

11 JAMES SCOTT,

12 Plaintiff,

13 v.

14 JANET A NAPOLITANO, DEPARTMENT
OF HOMELAND SECURITY,

15 DefendantS.
16

Case No. 08cv0735 BTM(JMA)

**ORDER DENYING DEFENDANT'S
MOTION TO ENFORCE
SETTLEMENT**

17 On September 18, 2012, the Court held an evidentiary hearing on Defendant's Motion
18 for Judgment Based on ADR Settlement. For the reasons discussed below, the Court holds
19 that Plaintiff can rescind the August 12, 2010 Memorandum of Settlement based on
20 unilateral mistake and **DENIES** Defendant's motion.

21
22 **I. BACKGROUND**

23 Plaintiff and Defendant filed competing motions to enforce settlement. In an order
24 filed on July 10, 2012, the Court denied Plaintiff's motion to enforce an alleged settlement
25 reached on July 28, 2011, and granted an evidentiary hearing on Defendant's motion to
26 enforce the August 12, 2010 Memorandum of Settlement ("Memorandum").

27 The Court granted an evidentiary hearing on the issue of whether Plaintiff could avoid
28 enforcement of the Memorandum based on unilateral or mutual mistake of fact. The Court

1 found that there was a factual question as to whether there was a mutual or unilateral
2 mistake with respect to (1) whether Plaintiff had the option of obtaining federal health
3 coverage through an OPM waiver; and (2) whether \$150,000 was sufficient to provide
4 comparable health coverage to Plaintiff and his family.

5 On August 31, 2012, Defendant filed an ex parte motion to cancel or limit the scope
6 of the evidentiary hearing. In an order filed on September 14, 2012, the Court granted in
7 part and denied in part the ex parte motion. The Court ruled that Plaintiff was not statutorily
8 eligible for an OPM waiver and limited the evidentiary hearing to the issue of whether there
9 was a unilateral or mutual mistake as to whether \$150,000 was sufficient to provide
10 comparable health coverage to Plaintiff and his family.

11 On September 18, 2012, the Court held the evidentiary hearing. The only witnesses
12 were Plaintiff James Scott and his wife, Lisa Scott.

13 14 **II. DISCUSSION**

15 After considering the testimony at the evidentiary hearing and reviewing the post-
16 hearing briefing, the Court concludes that Plaintiff may rescind the Memorandum based on
17 unilateral mistake - i.e., Plaintiff's erroneous belief that the \$150,000 designated by the
18 Memorandum to "defer the costs of health insurance for Plaintiff and his family" would be
19 sufficient to cover the premiums of the insurance plan he had in place at that time until he
20 reached the age of 65.

21 22 **A. Evidentiary Hearing Testimony**

23 Mr. Scott testified that obtaining a health care plan that was comparable to FEHB and
24 that he could afford was a very important issue during the settlement discussions.
25 (Evidentiary Hearing Transcript ("EHT") 27:19-28:1.)

26 When it became clear that the government could not provide FEHB benefits, the
27 \$150,000 figure was proposed as compensation in lieu of the benefits. (EHT 29:7-10.) At
28 the hearing, Mr. Scott testified that he thought that the \$150,000 was to provide health care

1 comparable to FEHB for him and his family. (EHT 29:12-13.)

2 However, Mr. Scott did not know how the \$150,000 figure was derived. He only
3 recalled that his wife had extensive conversations with the mediator and that the mediator
4 had come up with the figure based on the discussions. (EHT 28:7-15, 42:24-25.) Mr. Scott
5 did not follow the discussions his wife had with the mediator. (EHT 40:23-24.) Mr. Scott
6 trusted his wife to handle the family's financial and medical issues. (EHT 40:15-17.) Mr.
7 Scott relied on his wife, the "family expert," to handle medical insurance issues and
8 delegated those duties to her. (EHT 28:20-24.)

9 Because his wife handles medical insurance, Mr. Scott did not know how much he
10 was paying in premiums for his private plan with Kaiser at the time of the mediation. (EHT
11 26:12-14.) He also did not know how much in premiums he paid while he was on TCC
12 (COBRA). (*Id.* at 8-9.) He did not know what benefits the private plan afforded. (EHT 33:2-
13 5.) Mr. Scott's wife filled out health benefit forms, discussed medical issues with the agency,
14 determined premium costs, and wrote checks for the premiums. (EHT 34:20-35:2; 37:2-6,
15 22-25, 40:4-9.)

16 Lisa Scott also testified that the issue of health coverage was very important to her
17 and her husband because all three members of her family had preexisting medical
18 conditions and health care was difficult to obtain. (EHT 45:22-25.) Ms. Scott did not believe
19 that the \$150,000 would provide health care comparable to FEHB because the figure was
20 derived from the premiums she was paying at that time for the private "conversion" Kaiser
21 plan. (EHT 49:5-6.) The private plan was not as good as the FEHB plan due to higher
22 premiums, higher co-pays, deductibles, and non-covered costs, but it was the "best policy"
23 the Scotts could obtain due to their preexisting conditions. (EHT 50:21-52:10.)

24 Ms. Scott recalls that the mediator reached the \$150,000 figure by multiplying the
25 Scotts' monthly premium payment of \$1248 by 12 to reach an annual amount and then
26 multiplying the annual amount by 9 (the number of years until Mr. Scott reached "Medicare
27 age"). (EHT 49:8-14.) When it was pointed out to Ms. Scott that the actual product of those
28 numbers is \$134,784, Ms. Scott testified that she did not know why the proposed number

1 was \$150,000. (EHT 50:9-12.)

2 Ms. Scott explained that after the mediator did the math for her, he said that the
3 \$150,000 would cover the family's premiums. (EHT 50:15-16, 69:13-16.) Accordingly, Ms.
4 Scott believed that the \$150,000 would pay the entire amount of the premiums for their
5 current health insurance plan until Mr. Scott reached the age of 65. (EHT 68:15-17, 69:10-
6 11.)

7 Ms. Scott was an instrumental part of Mr. Scott entering in the settlement agreement.
8 (EHT 56:24-57:1.) Although she doesn't recall specific discussions with Mr. Scott regarding
9 the \$150,000 covering the premiums, she discussed the settlement with Mr. Scott and they
10 came to an understanding between themselves that the \$150,000 would pay for their health
11 benefits. (EHT 57:24-58:3.)

12 Later, Ms. Scott discovered that the \$150,000 would not cover the premiums for a
13 period of nine years. She discovered that the premiums increase annually at a higher rate
14 than expected and that the \$150,000 would be subject to taxes and attorney's fees. (EHT
15 51:4-13.) She learned that 40 percent of the \$150,000 would have to be paid as taxes.
16 (EHT 56:14-19.) Ms. Scott testified that she was not advised that she and her husband
17 would have to pay taxes on the money that they were going to use for health coverage.
18 (EHT 55:22-56:3.) According to Ms. Scott, her attorney did not mention taxes, and there
19 were no discussions about the tax consequences of the \$150,000 payment. (EHT 67:25-
20 68:3.) She explained, "By that late in the day, I wasn't thinking about taxes. The idea of the
21 - I have been in a car accident before and when you receive a settlement you don't have to
22 pay taxes. . . . So I don't know that I was aware." (EHT 67:20-24.)

23
24 B. Unilateral Mistake

25 Based on the testimony of Mr. and Ms. Scott, the Court finds that the parties'
26 settlement agreement was the result of a unilateral mistake of fact. The Scotts were led to
27 believe that the \$150,000 would be sufficient to cover the premiums of their current health
28

1 insurance for nine years, when, in fact, it would not be enough after deducting taxes.¹

2 As discussed in the Court's July 10, 2012 Order, under California law, a party may
3 rescind a contract if his or her consent was given by mistake. Cal. Civ. Code § 1689(b)(1).
4 A mistake of fact is "a mistake, not caused by the neglect of a legal duty on the part of the
5 person making the mistake, and consisting in . . . an unconscious ignorance or forgetfulness
6 of a fact past or present, material to the contract." Cal. Civ. Code § 1577. Where a party
7 wants to rescind a contract based on a unilateral mistake of fact and the other party has no
8 reason to know of and did not cause the mistake of fact, the party seeking rescission must
9 establish that: (1) he made a mistake regarding a basic assumption upon which he made the
10 contract; (2) the mistake has a material effect upon the agreed exchange of performances
11 that is adverse to him; (3) he does not bear the risk of the mistake; and (4) the effect of the
12 mistake is such that enforcement of the contract would be unconscionable. Donovan v. RRL
13 Corp., 26 Cal. 4th 261, 282 (2001).

14 The evidence shows that Mr. Scott made a mistake regarding a basic assumption
15 upon which he made the contract. Mr. Scott and Ms. Scott understood that the \$150,000
16 would be sufficient to cover their health care needs. Although Mr. Scott only had a vague
17 understanding of what the \$150,000 would cover, it is apparent that he was relying on the
18 assessment of his wife, who believed that the \$150,000 would be sufficient to cover the
19 family's health insurance premiums for their non-FEHB plan for the nine years until Mr.
20 Scott's retirement.

21 The government claims that the mediator just presented the math and Ms. Scott
22 *inferred* that the \$150,000 would cover the premium payments. To the contrary, Ms. Scott
23 testified, "When he [the mediator] said how much do you – how much is your premium, and
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25 ¹ The Court is not persuaded by Plaintiff's arguments regarding the annual increase
26 in premiums or attorney's fees. A mistake regarding the rate at which premiums would
27 increase annually would be a mistake of judgment. Generally, rescission is not allowed for
28 errors in judgment. M.F. Kemper Const. Co. v. City of Los Angeles, 37 Cal. 2d 696, 703
(1951). As for a mistake regarding whether attorney's fees would be taken out of the
\$150,000, Plaintiff should have known what fee arrangements had been made between
himself and his attorney. The Court notes that there was no evidence presented regarding
the fee agreement between Plaintiff and his attorney.

1 he multiplied it by nine years, he said that will cover your premiums.” (EHT 69:13-15.) Ms.
2 Scott further testified that nobody mentioned that the \$150,000 would be taxed, and she had
3 no awareness that taxes might become an issue. Given the quick pace at which information
4 is exchanged during mediations, accompanied by pressure to “seal the deal” on the spot,
5 Ms. Scott’s testimony is wholly believable.

6 Defendant has submitted a Declaration of Matthew G. English, the Scotts’ attorney
7 at the time of the mediation. In the Declaration, Mr. English explains that it is his practice
8 to advise his clients that settlements may have tax consequences and to include in his
9 attorney-client agreements a clause expressly advising the client that settlements may have
10 tax consequences. (English Decl. ¶ 2.) Mr. English states that he does not feel free to
11 reveal any communications between himself and Mr. Scott without a waiver. (English Decl.
12 ¶ 3.) The Court does not give any weight to Mr. English’s Declaration. Mr. English did not
13 testify at the evidentiary hearing, even though he was subpoenaed by Defendant, and was
14 not subject to cross-examination. Furthermore, Mr. English claims to have a lien in the
15 amount of \$361,367.30 on any settlement amounts and will benefit from the enforcement
16 of the Memorandum. At any rate, the fact that Mr. English may have told Mr. Scott at some
17 point in time that settlements generally may have tax consequences does not make it
18 unreasonable for the Scotts to accept the mediator’s specific factual assertion that \$150,000
19 would cover their health insurance premiums for nine years.² The Court denies Defendant’s
20 request to reopen because Defendant already had the opportunity to put Mr. English on the
21 stand.

22 Defendant argues that Plaintiff’s mistake was one of law, not fact. Under California
23 law, a mistake of law is a basis for rescission only where all parties misapprehend the law

24
25 ² Defendant also argues that there was no mistake because knowledge of Plaintiff’s
26 attorney is imputed to Plaintiff. “Information imparted to a lawyer during and relating to the
27 representation of a client is attributed to the client for the purpose of determining the client’s
28 rights and liabilities in matters in which the lawyer represents the client, unless those rights
or liabilities require proof of the client’s personal knowledge or intentions or the lawyer’s legal
duties preclude disclosure of the information to the client.” Rest. (Third) of Law Governing
Lawyers § 28 (2000). No evidence has been presented that Mr. English had knowledge that
the \$150,000 would not be sufficient to cover the premiums for nine years.

1 or one party misapprehends the law and the others are aware of the misapprehension but
2 do not rectify it. Cal. Civ. Code § 1578; Hedging Concepts, Inc. v. First Alliance Mortgage
3 Co., 41 Cal. App.4th 1410, 1421 (1996). A mistake of law is when a person knows the facts
4 as they really are, but has a mistaken belief as to the legal consequences of those facts.
5 Hedging Concepts, 41 Cal. App. 4th at 1421 n. 9. If Plaintiff was merely presented the
6 \$150,000 figure and Plaintiff erroneously believed that the amount would not be taxed, the
7 Court would tend to agree that Plaintiff made a mistake of law. However, here, Plaintiff was
8 told that \$150,000 would be sufficient to cover the premiums for nine years. The mediator's
9 assertion was a *factual* one. Therefore, the Court concludes that the mistake was primarily
10 one of fact and that mutual mistake is not required.³

11 The Court also finds that the mistake has a material effect upon the agreed exchange
12 of performances that is adverse to Plaintiff. In the post-hearing briefing, Defendant does not
13 dispute that the \$150,000 would be taxable. Although it is unclear at what exact rate the
14 \$150,000 would be taxed, the amount of the tax would almost certainly be significant.
15 Therefore, the Court can confidently say that the \$150,000 minus taxes would fall far short
16 of covering the health insurance premiums for nine years.

17 Defendant does not argue that Plaintiff bore the risk of the mistake, but disputes that
18 the enforcement of the agreement would be unconscionable. Defendant points out that the
19 \$150,000 was just a portion of the \$655,000 and argues that Plaintiff has not shown that he
20 could not afford insurance with the remainder of the insurance proceeds. The Court is not
21 persuaded by this argument. The Scotts were particularly concerned about health benefits,
22 and the provision of FEHB, or payments in lieu thereof, was a separate point of negotiation.
23 The remainder of the \$655,000 was meant to cover other damages. In light of the
24 significance of health benefits to the Scotts, the fact that the \$150,000 actually would not
25 come close to covering their premiums for nine years renders enforcement of the
26 Memorandum unconscionable.

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28 ³ For the same reasons, the Court rejects the government's argument that the
mistake was one of judgment.

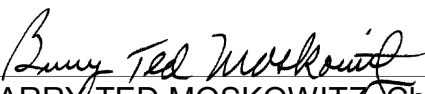
1 In sum, the Court finds that Plaintiff has satisfied the requirements for rescission
2 based on unilateral mistake. Therefore, the Court denies Defendant's motion to enforce the
3 Memorandum.

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5 **III. CONCLUSION**

6 For the reasons discussed above, Defendant's Motion for Judgment Based on ADR
7 Settlement [Doc. No. 83] is **DENIED**.

8 **IT IS SO ORDERED.**

9 DATED: September 27, 2012

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11 BARRY TED MOSKOWITZ, Chief Judge
12 United States District Court
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